THE FUTURE OF THE NATIONAL BANKING SYSTEM.

The National Bank Act requires that banks having a capital of $150,000 and more than that amount, shall keep on deposit with the Treasurer of the United States not less than $50,000 of United States bonds as security for circulating notes, and that banks having a capital of less than $150,000 shall keep on deposit an amount equal to one-fourth of their capital as security for circulation. Circulation has ceased to be a profit, and, in many cases, is a burden to the National banks under existing laws. Many of the small banks of the country hesitate to organize under the National system, because they are obliged to buy United States bonds at the present high premium. Legislation is therefore suggested, which will authorize all banks having a capital in excess of $150,000 to keep on deposit $25,000 of United States bonds; and all banks having a capital of from $50,000 to $150,000, to keep on deposit an amount equal to one-eighth of their capital; or, what probably would be still better, authorize the smaller banks having a capital of from $50,000 to $75,000 to organize upon a deposit of $5,000, and banks with a capital of $75,000 and less than $150,000, to organize or continue business upon a deposit of $10,000 of United States bonds. This would permit all National banks which do not desire circulation, to conform to the law without the necessity of purchasing United States bonds at the present high rate of premium.

Such a bill would be improved if the amount of circulating notes to be issued should be increased to one hundred per cent. upon the par value of the bonds, instead of ninety per cent., as now authorized by law. This would be in accordance with the McPherson bill, which passed the Senate last winter, but which failed to pass the House. Indeed, the premium upon 4 per cent. and 4½ per cent. bonds is now so high in the

market, that the percentage of issue could be largely increased with safety to the bill holder. A law which authorizes the issue of ninety per cent. upon 3 per cents., worth only par in the market, and only ninety per cent. upon a 4 per cent. bond, worth 128 in the market, would seem to be imperfect. The holder of $100,000 of United States 4 per cent. bonds can readily borrow $120,000 in the New York market upon such bonds as collateral, and many banks hesitate to deposit bonds as security for circulation, which have a margin of more than one-third upon the amount of circulation issued. The rate of issue upon 4 per cent. and 4½ per cent. bonds should be increased to ninety per cent. upon the average market value of the bonds for the six months previous; and if, at any time, the security should be deemed to be insufficient, the Comptroller can call upon the banks for an increased amount, as now authorized by law, or the circulation can be reduced as the bank notes are redeemed from the five per cent. fund, deposited by the banks in Washington for that purpose, and the Treasurer can also be authorized to withhold the interest upon the bonds.

2. Provide for the refunding of the 4 per cent. bonds, amounting to $738,000,000 now outstanding, into 2½ or 3 per cent. bonds, offering the inducement to the holders of these bonds to exchange them for the new ones to be issued, the Government paying to the holders the difference between 2½ per cent., or 3 per cent., and 4 per cent.—the difference in value to be ascertained by an exact calculation by the Actuary of the Treasury Department.

If a farmer had a long mortgage upon his farm, bearing 8 per cent. interest, and he had the ready means to pay a portion of the amount, it would be a good proposition for him to offer the holder of the mortgage a payment of interest in advance, reducing the rate of interest upon his mortgage from eight per cent. to five per cent. if possible. There would be no difficulty in a farmer understanding a proposition like that. He would be able to use his ready means and improve his credit, and the transaction could be so arranged that the party to whom he made the payment would also be benefited by receiving his interest in advance.

In like manner the Government, having a large amount of surplus funds on hand, can use say 100 million dollars of that surplus by giving to the holders of the 4 per cent. bonds an

opportunity to exchange their 4s for a bond bearing a less rate of interest, the Government paying to the holders of the 4s the difference between that rate and a lesser rate for the next twenty years in advance.

It can be shown that such a proposition, if carried out, would be to the advantage not only of the Government, but also to the advantage of the bondholders. The former would reduce its surplus and really pay in advance a portion of its outstanding interest debt upon favorable terms, which otherwise it will be compelled to pay hereafter in annual installments for twenty years, and the latter would then have the use of a large amount of funds now invested in premiums which would be available for loans at rates greatly exceeding the borrowing power of the Government.*

It is believed that if the bill should pass authorizing the refunding of the fours into two-and-a-halfs, that the former would be presented to the Treasury for that purpose. United States bonds are held for a specific purpose. National banks hold them as security for circulating notes or for Government deposits. Savings banks and trust companies hold them as a reserve; and insurance companies and other corporations are required by law to deposit them with the State authorities. A bond of the United States bearing a less rate of interest could be used equally well for all these purposes.

If private individuals are the owners, it is because United States bonds are exempt from taxation, and afford to them, as they believe, the safest form of investment.

According to a report of the Actuary of the Treasury Department, an investment in the fours in the month of November last, realized to investors an average rate of interest of 2.32 per cent. only. The holder of the fours, by converting them into the new bonds, could still possess every advantage he now enjoys, and would realize a slightly increased rate of interest; while a large amount of principal now invested in premium, which is unremunerative,—in the aggregate more than 100 millions,—would be replaced in his hands for investment in United States bonds or in any other funds yielding a greater income.

The value of the new two-and-a-halfs could be increased, and the inducement to the holder to make the exchange also increased, by providing that the circulation to be issued upon the new bonds,

* Report of Comptroller of the Currency, 1882, p. 21.

when deposited by the National banks as security therefor, shall not be subject to the present tax of one per cent. per annum, or, if taxed, not exceeding one-half of one per cent., making the bonds more desirable as a basis for circulation than either the fours or the four-and-a-halfs, which will soon be the only bonds outstanding.

It would seem to be plain that if the necessary legislation is not obtainable from Congress for authorizing this conversion, it is not because the financial policy, and the necessity for such legislation, is not apparent.

If the rate were reduced to 2½ per cent., all the public debt of the United States would then, four years hence, in 1891, be at a lower rate of interest than that of any other government.

The Government will undoubtedly decline to purchase the 4s for its sinking fund at the present high rate of premium, but if it should authorize the payment of its interest in advance, and reduce this debt from the present rate to 2½ per cent., it could then, subsequently, if thought advisable, after the 4½s are paid, in the year 1891, purchase the new 2½ per cent. bonds then outstanding, which would be redeemable in the year 1907.

3. Provide a safety fund from the tax upon circulation, which should be reduced to ½ per cent. per annum, and from the estimated loss arising from the failure to present lost or worn out National bank notes for redemption during the last twenty years, amounting to about $4,500,000. When this safety fund amounts to $5,000,000, authorize the issue of circulating notes at the rate of $100,000 of circulation upon $80,000 of bonds; the loss, if any, from the inability of insolvent banks to redeem their circulating notes, to be charged and paid from this safety fund. The statistics in reference to the failure of National banks during the last twenty years shows that if circulation had been issued at the rate of $100,000 upon $80,000 of United States bonds deposited, there would have been no loss whatever to the holders of the circulating notes of insolvent banks. But with a safety fund in hand of $5,000,000, steadily increasing by a tax of one-half per cent. upon the circulation outstanding, there would be no possibility of loss to the holders of the notes of an insolvent National bank if such notes were issued at the rate of $100 for every $80 of United States bonds deposited.

The banks might also be authorized, at their option, to deposit

in part gold or silver coin or bullion instead of United States bonds, and such a circulation would be greatly to be preferred to the silver certificates now in circulation.

If, however, the 4 per cent. bonds could be funded into 2½s by the payment of interest in advance, and circulation issued at par upon the bonds, and the present tax upon circulation repealed, the issues of the National banks could be maintained without the necessity of a safety fund, until the maturity of the bonds.

Either one of these propositions would give relief to the banks, and all combined would have the effect of continuing the National bank circulation for twenty years, or until the date of the payment of the 4 per cent. bonds now outstanding. Under such an arrangement the circulation of the National banks would not be likely to diminish, but would increase during the next twenty years. These propositions provide for an absolutely secure National bank circulation. They are eminently practicable and easy to execute, if the proper legislation can be obtained.

In any event, there is no reason why a law should not be passed authorizing National banks, if they desire, to reduce their circulation and the bonds required to be held as security therefor, and authorizing that circulation shall be issued at par upon the bonds, as previously provided in the McPherson bill. Surely all parties can agree to allow National banks to retire a portion of their circulation and their bonds, if they desire to do so.

The report of the Comptroller of the Currency for 1886 shows a decrease in the circulation of the National banks for the year ending November 1, 1884, of $24,170,676 ; in 1885, of $15,545,461, and in 1886, of $56,593,533, making a total of $96,309,670. The banks hold 57 millions of threes, all of which will be called in the course of a few months—reducing the circulation from 210 millions, the present amount, to about 170 millions during the coming midsummer months, and increasing the funds on deposit in the Treasury for the retirement of National bank notes from 88 millions on December 1 to nearly 120 millions.

It is evident that unless legislation is obtained during the present session of Congress, the National bank notes now outstanding are to be largely reduced, and that silver certificates are to be issued in their stead ; but it does not follow that on this account the National banking system will cease to exist, for the system will continue as long as the banks continue to hold the

minimum amount of bonds required by law. The banks which have been organized during the last few years have not been organized on account of the profit upon circulation, but rather because it is found by experience that a bank can more certainly build up a deposit account under the National system than any other. This is very evident from the numerous conversions of State banks and private bankers into the system, and the numerous organizations in the new States and Territories, where the rates of interest are so high that there is a loss, instead of a profit, on circulation; and also from the fact that many associations which have left the system on account of the restrictions of the act, have found it to their interest again to return. So long as the National banks continue to retain their reputation as the safest places of deposit, the system will attract to itself new organizations and continue to retain the old.

It is probable that, not long hence, the constitutional question will be raised whether Congress has not the power to authorize the organization of National banks without requiring them to deposit any United States bonds whatever, and in view of a recent decision of the Supreme Court, there would not seem to be much doubt as to the construction of such a law by that tribunal.

If a law should be passed authorizing the National banks to reduce the bonds now on deposit to one-half the amount now required, as given in the first proposition, the National banking system could continue during the next twenty years upon an aggregate deposit of about $50,000,000 of bonds by the different banks now organized, or which are likely to be organized, until the year 1907; and in the course of the next twenty years many strange things may happen, and among them, possibly, an increase of the National debt.

JOHN JAY KNOX.

NOTE.—Since this article was written, bills have been introduced by Senator McPherson, of New Jersey, and Hon. James F. Miller, Chairman of the Committee on Banking and Currency of the House, authorizing a reduction of the bonds held as security for National bank notes. The bill of Senator McPherson, like his previous bill, which was first presented in the year 1883, and which passed the Senate during the last Congress, contains a clause providing for the issue of circulating notes at the par value of the bonds, while the House bill provides for the issue of ninety per cent. only, in accordance with the present law.

Senator Aldrich, of Rhode Island, on December 18th, renewed his proposition, which was under consideration in 1883, providing for the refunding of the long

Government bonds into $2\frac{1}{2}$s, and for the payment of maturing bonds having a higher rate of interest previous to those bearing a lesser rate.

On December 13th, Hon. Abram S. Hewitt, of this city, introduced a bill in the House, authorizing the Government to anticipate the payment of interest on the bonded debt, in excess of the rate of three per cent.; for stamping the bonds which are presented so as to show the reduced rate of interest; and also authorizing such stamped bonds to be received as security for the issue of circulating notes to the National banks, at the par value thereof. The first section of this bill is as follows:

SECTION 1. That out of any money in the Treasury not otherwise appropriated, the Secretary of the Treasury is hereby authorized and empowered, to anticipate the payment of so much of the interest on the interest-bearing bonds of the United States as shall be in excess of the rate of 3 per cent. per annum, by the payment in gross of such sum in each case as shall be equal to the aggregate present worth of such excess of interest thereon. And for the purpose of ascertaining such present worth, the interest upon the amount paid by the United States in anticipation of such excess of interest shall be computed at the rate of 3 per cent. per annum reinvested quarterly, so as to secure to the United States the benefit of compound interest thereon.